

SURREBUTTAL TESTIMONY OF J. THOMAS O'BRIEN

BACKGROUND

Q. Please state your name, title and business address.

A. J. Thomas O'Brien, Executive Director-Regulatory Affairs,  
Ameritech Illinois, 225 W. Randolph Street, HQ27C, Chicago,  
Illinois 60606.

Q. Are you the same J. Thomas O'Brien who previously filed  
direct and rebuttal testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to respond to the  
rebuttal comments of ICC Staff and others regarding certain  
aspects of the operation of the Plan. The rebuttal testimony  
of the Intervenor and ICC Staff primarily restates their  
positions on issues which have already been debated at length  
in the proceeding, and are fully addressed in my rebuttal

testimony. Therefore, I will only provide a few additional comments on some of the concerns raised by the Intervenor and ICC Staff.

PRICING FLEXIBILITY

Q. Mr. Koch contends that your compromise position on the degree of pricing flexibility to be accorded under the Plan has "validated his concerns". (Staff Ex. 27.0, p. 20). Is that what you intended?

A. No. I still believe that the Company's original proposal is appropriate. However, it is critically important that some additional pricing flexibility be built in to the Plan. As a practical matter, the Company would rather have some pricing flexibility (even if it is not enough for the long run) than none, as Staff proposes.

Q. Mr. Koch nevertheless rejects your compromise position on the grounds that it could still result in rate increases in noncompetitive services. (Staff Ex. 27.0, p. 20). Is his response appropriate?

A. No. Mr. Koch is being extraordinarily rigid on this issue. His definition of "harm to ratepayers" equates to any increase in noncompetitive rates. In effect, Mr. Koch is insisting that all of the Company's noncompetitive rates be capped at current levels and maintained at those levels for the indefinite future. This "cap it and forget it" approach to Ameritech Illinois' rate structure is totally inappropriate, given the length of time that Ameritech Illinois' access line rates have been capped already and the changes occurring in the marketplace. It is in the best interests of consumers and the Commission for the Company to make incremental progress towards better rate design over a period of years, rather than having to rely on significant "step" increases in access line prices. "Harm" to ratepayers must be assessed in a much broader context than Mr. Koch is utilizing.

Q. Ms. TerKeurst also reiterates her support for a cap on residence network access line prices. (GCI Ex. 11.0, pp. 46-47). Please comment.

A. Ms. TerKeurst also views rate design policy from the sole perspective of preventing increases in residence network access line prices. This is short-sighted and inconsistent

with one of the objectives of price regulation - i.e., to allow the regulated company some flexibility to improve its rate structure over time. Ms. TerKeurst's approach is more akin to "rate moratoria" regulation under Section 13-506.1(a), than it is to "price regulation".

Q. Ms. TerKeurst notes in several places that residence network access line prices were not reduced during the term of the Plan. (GCI Ex. 11.0, pp. 45, 48). Please explain why.

A. Residence network access line prices were not decreased during the Plan because they were too low at the time alternative regulation was implemented. Moreover, such reductions would have rolled back the rate increases which the Commission accomplished in Ameritech Illinois' MSA-1 and 1989 rate cases and would have represented a step backwards in rate design.

#### BASKET CONSOLIDATION

Q. Mr. Koch defines customer class discrimination in the context of the Plan. (Staff Ex. 27.0, p. 21). Do you agree?

A. No. Mr. Koch's definition of class discrimination is that all classes of customers should receive their own share of any rate reductions. However, that definition presupposes that the rates at the beginning of price regulation were set appropriately and that no underlying changes that would warrant differential changes in price levels across customers have occurred. However, unwarranted pricing differences between business and residence network access lines existed when the Plan was adopted. The network access line rates for business and residence are shown in Table 1 below:

Table 1

	<u>Residence</u>	<u>Business</u>
Access Area A	\$2.55	\$5.13
Access Area B	\$5.53	\$8.97
Access Area C	\$9.00	\$12.50

Since both residence and business network access lines have the same cost this price differential.

Q. Mr. Koch suggests that the Company can reduce business rates if it wants to rectify these rate differences. (Staff Ex. 27.0, p. 22). Is that a reasonable solution?

A. No. Reducing business network access line rates to residence network access line rates would simply exacerbate the problem

and make Ameritech Illinois' rate structure even less rational than it is today.

CALCULATION OF THE API

- q. Mr. Koch continues to express concern about his ability to validate the Company's API in the compliance filings. (Staff Ex. 27.0, p. 24).
- A. As I indicated in my rebuttal testimony, I believe that Mr. Koch's concerns were addressed by the Commission in its Order in the last annual filing. In any event, the Company is willing to work cooperatively with Mr. Koch to develop processes that will facilitate his review of the API.

OTHER PLAN ISSUES

- Q. Ms. TerKeurst noticed an inconsistency between your rebuttal testimony and the Plan document in Schedule 1 relating to the future review of the Plan. What is your response?
- A. The Company does not support a formal, scheduled review of the Plan, and Schedule 1 was in error. However, if a review is ordered, a review in 2003 is much too soon. In 2003, only

data from 2002 would be available for review. If a review is deemed necessary, then 2007 is the appropriate year, since five full years of experience would then be available for review.

#### MERGER SAVINGS

Q. At page 8 of her Rebuttal Testimony, Ms. Marshall takes issue with your recommendation that the final computation of net merger savings should be based on actual 2002 results. Do you have any comments on Ms. Marshall's testimony in this regard?

A. Yes. Ms. Marshall asserts that, because approximately ninety-six percent (96%) of the going level of merger savings will have been reached by the year 2002, some savings in benefits and procurement may not be fully reflected in the year 2002 results. Ms. Marshall also cites to a recommendation of the independent auditor, Barrington Wellesley Group, Inc. ("BWG") that the Commission shall consider extending the three year period for sharing of net merger savings. The Company continues to believe that the final computation of net merger savings should be calculated on actual 2002 results. The difference between complete

realization of the going level of savings and the 96% figure used by Ms. Marshall is attributable to the inflationary effect on wages and does not represent additional savings resulting from significant merger initiatives.

Q. Ms. Marshall recommends that the Commission continue to require annual audits of merger costs and savings through the year 2004. Do you agree with Ms. Marshall's recommendation?

A. No. The Company's processes and methods to identify, track, and report merger costs and savings were subject to an extensive audit conducted by BWG over an eight month period in accordance with the merger order. The results of that audit have been reported to the Commission with the issuance of BWG's final audit report. While the Company agrees that any reported results are subject to Commission review and scrutiny in the future, the engagement of an actual audit is not required in the merger order nor necessary.

Q. Ms. Marshall recommends that computation of the permanent, going forward level of merger savings be deferred until actual data is available for the year 2005, after which a one time adjustment would be made to the PCI in the April 1, 2006



price cap annual price cap filing. Do you agree with Ms. Marshall's proposal?

A. No. For the reasons discussed above and in my Rebuttal Testimony, the Company's position is that actual net merger savings for the year 2002 should be considered the permanent, going forward level achieved into the future. The Company proposes that a one time adjustment to the PCI to reflect that this ongoing savings level be made in the April 2003 annual price cap filing. For the reasons discussed in my Rebuttal Testimony, Staff's proposed delay in making an adjustment to the PCI would not be in the best interest of either the Company or its customers. As I also discussed, however, if Staff believes that the 2002 net merger savings review cannot be completed in time for inclusion in the 2003 annual price cap filing, Ameritech Illinois would support a separate filing after the 2003 annual filing. The merger related savings could be passed along to customers outside the annual filing, as I have proposed for other exogenous changes.

Q. As an alternative to the Staff's main proposal, Ms. Marshall suggests that the Commission could adjust the Alternative Regulation formula in this proceeding to calculate merger

savings based on current estimates rather than actual data.

Does the Company support this alternative?

- A. No. The use of actual data versus estimated data was fully debated during the Merger proceeding, in Docket 98-0555, and the Commission concluded that use of actual data is appropriate. In the Company's view, nothing has occurred which should cause the Commission to change its conclusion. Ms. Marshall concludes that that since targets were firm and management reviewed plans, the current projection of planned net merger savings has "a high probability of being achieved." Marshall's statement is highly conjectural. The acts of setting firm targets and reviewing plans does not create a high probability of success. Numerous factors can impact a team's ability to achieve its planned merger savings. Therefore, the Company believes it is appropriate to continue to measure actual savings and to report these savings annually.

#### CONCLUSION

- Q. Does that complete your surrebuttal testimony at this time?

- A. Yes it does.